

Message Text

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ACTION ARA-20

INFO OCT-01 ISO-00 AGR-20 AID-20 CIAE-00 COME-00 EB-11

FRB-02 INR-10 NSAE-00 RSC-01 TRSE-00 XMB-07 OPIC-12

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R 111400Z DEC 73

FM AMEMBASSY MANAGUA

TO SECSTATE WASHDC 3084

INFO AMEMBASSY GUATEMALA

AMEMBASSY SAN JOSE

AMEMBASSY SAN SALVADOR

AMEMBASSY TEGUCIGALPA

C O N F I D E N T I A L MANAGUA 4788

GUATEMALA ALSO FOR ROCAP

SAN SALVADOR ALSO FOR AGATT

E. O. 11652: GDS

TAGS: EAID, FIN, NU

SUBJECT: EMERGENCY TAXES, POLITICS AND THE RECONSTRUCTION

1. IN JANUARY 1973, GENERAL SOMOZA IMPOSED A TWO-YEAR, 10 PERCENT EMERGENCY TAX ON AGRICULTURAL EXPORTS TO REPLACE ANTICIPATED REVENUE LOSSES DUE TO THE EARTHQUAKE AND TO DEMONSTRATE NICARAGUA'S WILLINGNESS TO UNDERTAKE SUBSTANTIAL SELF-HELP MEASURES FOR THE RECONSTRUCTION OF MANAGUA. IT FIRST WAS ESTIMATED THIS TAX WOULD PRODUCE \$13-14 MILLION ANNUALLY. HOWEVER, AS THE YEAR HAS PROGRESSED, THE ECONOMY IN GENERAL AND REVENUES IN PARTICULAR HAVE RECOVERED MORE RAPIDLY THAN EXPECTED. REVENUE FROM NORMAL TAX SOURCES IS RUNNING 12.7 PERCENT AHEAD OF LAST YEAR TO TO INCREASED RECEIPTS FROM INDIRECT TAXES AND EMERGENCY TAXES HAVE ADDED 24

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PERCENT TO TOTAL RECEIPTS. BY YEAR'S END THE EMERGENCY TAXES SHOULD PRODUCE WELL OVER \$21 MILLION, AN AMOUNT

ROUGHLY EQUAL TO ONE-THIRD OF THE GON'S CAPITAL EXPENDITURES FOR THE YEAR.

2. THE EMERGENCY TAX PACKAGE HAS BEEN AN UNQUALIFIED FISCAL SUCCESS, PROVIDING THE GON WITH READILY AVAILABLE FUNDS OF ITS OWN TO START RECONSTRUCTION AND INSPIRING THE CONFIDENCE OF INTERNATIONAL LENDING AGENCIES. HOWEVER, THE EMERGENCY EXPORT TAX IS UNPOPULAR AND THE GON IS UNDER STRONG PRESSURE TO REPLACE IT BEFORE THE TWO YEAR TERM EXPIRES. OPPONENTS ARGUE THE TAX SERVES AS A DISINCENTIVE TO INVESTMENT AND PRODUCTION IN THE AGRICULTURAL SECTOR. HOWEVER, THIS ARGUMENT OVERLOOKS THE EXCEPTIONALLY FAVORABLE PRICES IN WORLD MARKETS FOR NICARAGUA'S PRINCIPAL EXPORTS AND IS BELIED BY SUBSTANTIAL NEW INVESTMENTS IN AGRICULTURAL PRODUCTION THIS YEAR.

3. THE CHIEF OPPOSITION TO THE EXPORT TAX COMES FROM THE LARGE AND MEDIUM-SIZED COTTON GROWERS WHO HAVE SOLD MUCH OF THEIR CROP ON FUTURE CONTRACTS AT PRICES WELL BELOW CURRENT WORLD MARKET LEVELS. THESE GROWERS SEE THE POSSIBILITY OF UNPRECEDENTED PROFITS SLIPPING THROUGH THEIR GRASP. THEY WOULD LIKE THE GOVERNMENT TO TAKE ACTION WHICH WOULD ALLOW THEM TO BREAK THEIR FUTURES CONTRACTS OR, BARRING THAT, TO LIFT THE EXPORT TAX EVEN THOUGH THEIR SALES VALUE SHOULD INCREASE 60 PERCENT OVER LAST YEAR IF THE GOVERNMENT DOES NOTHING. THE COTTON GROWERS ARE SUPPORTED BY OTHER AGRICULTURAL PRODUCERS WHO ALSO HOPE FOR RELIEF FROM THE UNACCUSTOMED TAX BURDEN.

4. THESE PRESSURES CANNOT FAIL TO HAVE POLITICAL IMPACT IN 1974, AN ELECTION YEAR, AND GENERAL SOMOZA IS A SKILLED POLITICIAN WHO TAKES PRIDE IN HIS ABILITY TO ANTICIPATE POLITICAL PROBLEMS AND TO RESPOND TO THEM WITH FLEXIBILITY. WE BELIEVE SOMOZA IS UNDER STRONG PRESSURE TO MODIFY THE EXPORT TAX FROM HIS OWN PARTY, THE OPPOSITION AND PERHAPS EVEN HIS OWN FAMILY (WHICH WILL PAY AN ESTIMATED \$3 MILLION IN 1973). HE HAS A NUMBER OF OPTIONS AVAILABLE TO HIM RANGING FROM
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MAINTAINING THE PRESENT TAX, TO MODIFYING IT SLIGHTLY OR REMOVING IT ALTOGETHER AND RELYING ON A RESURGENT ECONOMY TO FILL THE GAP WITH HIGHLY REGRESSIVE INDIRECT TAXES.

5. WE BELIEVE THE U. S. INTEREST IS TO ASSURE A CONTINUED MAXIMUM SELF-HELP EFFORT FOR THE SHORT TERM AND FOR THE LONGER TERM TO SECURE A FIRM GON COMMITMENT TO EFFECTIVE REFORM OF THE EXISTING HIGHLY REGRESSIVE TAX SYSTEM. WE SHOULD MAKE THIS CLEAR TO THE GON AND

OPPOSE ANY POSSIBLE SUGGESTION OF SIMPLY LIFTING THE EXPORT TAX
AND RELYING, IN EFFECT, ON THE NICARAGUAN POOR AND
FOREIGN DONORS TO FOOT THE BILL FOR RECONSTRUCTION.

6. A MORE DETAILED ANALYSIS OF THE BACKGROUND, ISSUES
AND ALTERNATIVES IS CONTAINED IN EMBASSY AIRGRAM A-76
DATED DECEMBER 6, 1973.
SHELTON

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